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On Politics

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Please send submissions to onpol@uvic.ca with the article and notes attached as a single Word document. Any references made to the author's name within the document shall be removed during the peer-review process. Further inquiries should be directed to onpol@uvic.ca

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In Memory of Leo Chan

This issue of On Politics is dedicated to the memory of Leo Chan, an active Political Science student at the University of Victoria who passed away this year. Leo was a hard-working student and a fantastic writer.

Recent Neo-liberal Policy at the Federal and Provincial Levels

Impacts on First Nations Women in British Columbia

Elyse Goatcher-Bergmann

As former National Action Committee president Judy Rebick once said, “Native women are the most vulnerable group in Canadian society.”¹ Whether or not they deserve the superlative place as Canada’s most vulnerable group, First Nations women are disproportionately subjected to more violence, poverty, and human and civil rights abuses than most other groups in Canada.² Their condition is no doubt deserving of study and rectification. Using the lens of gender as a social position, I will explore First Nations women’s oppression to demonstrate that other factors, such as race and class, intersect to further define their position in relation to the structures of the state.³ By exploring the themes of poverty, social services, political influence, and violence, this paper will examine the negative impacts of neo-liberal policies on First Nations women, as well as how the Canadian provincial and federal governments are implicated in the further marginalization of a group already on the fringes of society.

As a political and economic policy, neo-liberalism has been a growing force in Canadian politics since the 1980s.⁴ Unfortunately, strategies such as market liberalization, deregulation, and other hallmarks of neo-liberal ideology at the federal and provincial levels have had an increasingly prejudicial and harmful effect on women as a class and First Nations women as a group. Although the link between the economically focused principles of neo-liberalism and the specific targeting of certain groups and classes may not be immediately apparent, this paper intends to clarify their

connection and to shed light on the damaging consequences that have already taken effect.

Neo-liberalism

Let us begin by reflecting on what it means to hold a neo-liberal point of view in Canada. Fuller et al. describe neo-liberalism as placing primary emphasis “on engagement in the market, self-sufficiency, and individual responsibility.”⁵ As Sylvia Bashevkin notes, along with this emphasis comes “a presumed lack of personal responsibility and self-sufficiency among social assistance recipients.”⁶ She further observes that the current government’s discourse on poverty “no longer frame it as an economic condition but as a cultural, and moral malady.”⁷ More to the crux of my argument, this neo-liberal conception of “the good citizen” has allowed neo-conservatives in the Harper government to discredit Native women based on their race, class, and gender identities and to frame them with a negative moral character that is undeserving of tax-payer dollars. In this way, by negatively framing a specific group, the Canadian population is becoming more acquiescent to the financial cuts and demands of neo-liberalism on the poor.⁸ Citizens wary of global economic problems allow stereotypes and essentialism to be perpetuated through the government’s economic policy. Gone are the Mulroney days that promised a “sacred trust” of universalism and social programs.⁹ The current Canadian government has used a neo-liberal economic ontology to implicitly support neo-conservative policies that further subjugate and moralize groups who do not fit in to traditional conservative roles.

Since 2006 the Conservative Party has formed the Canadian government. Although the Conservative Party espouses “A belief in the equality of all Canadians” on its website under the heading of *Founding Principles*, more prominently displayed in the enumeration of its values is the belief in “individual rights and responsibilities.”¹⁰ The Conservative Party has promoted an

increasingly neo-liberal approach to politics and the role of the state within Canada. It is the inherent individualism and transposition of economic principles onto the realm of politics that has weakened the importance of collective norms, social programs and social justice at the federal and provincial levels.¹¹

As understood by the Conservative government, the role of the state is restricted to being fiscally prudent and limiting its responsibilities to those which cannot reasonably be discharged by the individual.¹² At its core there exists the belief that the best guarantors of well being for Canadians are freedom of the individual to pursue their own self-interest within the economy, and the right to own property.¹³ Inherent in this belief is the patriarchal principle that paid work is the determining factor in citizenship and the prerequisite for worth. Furthermore, by only recognizing contributions to society made in the public moneymaking sphere, neo-liberal thought denigrates contributions made by women in other areas while simultaneously solidifying the government's own self-exclusion from domestic/private sphere matters such as family violence.

Finally it is also important to recognize the implicit patriarchal foundations of neo-liberalism.¹⁴ It is patriarchy that allows men and women to assume that there exists a one-size-fits-all form of family, government and economic order. As Margaret Thatcher once stated, to the enthusiastic reception of neo-liberals for decades to come, "There is no such thing as society. There are individual men and women and there are families."¹⁵ Policies that are based on ideologies of free market economics, privatization, and individual responsibility regardless of the individual's position within society are implicitly placing power and importance on those who directly contribute the most to the country's Gross Domestic Profit.

Poverty

The ways in which the neo-liberal emphasis on individualism manifests itself in social policy are widespread. With regards to First Nation's women, one of the simplest ways to discern the implications of self-sufficiency and individual responsibility discourses is to study income, or the lack thereof. First Nations women are more likely to be impoverished in Canada due to their intersectional identities that encompass several marginalizing criteria including race, gender, class, and geographic location.¹⁶ The disparity between the social and economic conditions of First Nations women and the rest of Canada is striking and clearly demonstrates the primacy of the market economy over the priority of the welfare of all Canadians.¹⁷

The budget cuts to social welfare programs by the federal and B.C. provincial governments in the last decade have significantly decreased the number of eligible persons for welfare. Although B.C. recorded its lowest unemployment rate in years (3.2%) in 2008, critics maintained that employment at the current minimum wage, underemployment and the prevalence of part-time work for women and aboriginals have not led to a reduction in the need for access to welfare support.¹⁸ According to the report done by VIPIRG, data obtained through freedom of information acts have shown that after the new welfare criteria were introduced in 2002, the number of applicants who were successful in attaining income assistance dropped from 90% in 2001 to 51% in 2004.¹⁹ The British Columbia government places a high value on the recipient having been "independent" for at least two years prior to receiving welfare subsidies.²⁰ This expectation, plus the weight placed on paid work as a criterion for social assistance, discriminates against those most likely to have been dependents, i.e. women.

Because women are twice as likely to occupy lower wage earning positions in order to fulfill family obligations and other

gender specific roles in the private sphere, poverty is becoming more and more of a gendered issue.²¹ First Nations people on the whole are also more likely to be employed part time or for only part of the year.²² Not only are Native women subjected to the feminization of poverty, but on average they also earn 25% less than other women in Canada based on their race and other limiting factors.²³ This means that the average wage of an Indigenous woman is 47% that of a non-indigenous Canadian male.²⁴ Consequently, any decrease in social assistance to the B.C. population is intrinsically damaging to Native women due to their current economic and social positions defined by race and gender.

Social Services

The British Columbia Liberals have used the recent cuts in federal funding to justify several other social services cuts that have significantly impacted the lives of Aboriginal women. The abolition of the Human Rights Commission of B.C. as well as the almost complete elimination of legal aid services has reduced access to citizens seeking redress from discriminatory practices that are contradictory to the Charter of Human Rights of Canada.²⁵ Since Charter Rights deal almost exclusively with claims concerning sexual and racial discrimination, Aboriginal women are left with few options to seek restitution.²⁶

In addition to legal aid, the province has also closed many rural courthouses. In contrast to the rest of the Canadian population where 80% live in urban settings, only 45 % of First Nations live in cities.²⁷ Not only have Liberal policies favored economic projects in urban areas, but we have also witnessed outright discrimination towards the rural population in terms of services.²⁸ Aboriginal reserves often lack healthcare, education and legal services. None are aspects for which one could reasonably expect the “individual” to be responsible, and all of which are under the mandate of the provincial government.²⁹ Because free market principles expect that private services will go where there is

demand and money, the lack of a local economy on reserves should be a red flag for needed government intervention. However, the neo-liberal agenda of the B.C. government has been intent on shifting responsibility for health and welfare back onto the Indigenous people.³⁰ First Nations communities in B.C. are facing an extremely difficult situation in trying to alleviate the cycle of poverty, a situation that disproportionately affects women as noted above.

The Harper government is complicit in the subordination of First Nations women in British Columbia as it has the power to influence provincial policy by attaching stipulations to federal transfer payments to the provinces.³¹ Although this power can be used to the advantage of marginalized people, the Conservatives have chosen instead to extend their policy of defunding women's organizations at the federal level to the provinces. Instead of ensuring that money be directed to Indigenous women in need, federal grants have taken the form of block funding. Block funding employs a lump sum directed toward several policy areas at the same time, such as education, social welfare and healthcare.³² This type of grant has allowed the provincial government to choose policies deemed most important, and has removed responsibility at the federal level to impose national standards.³³

By leaving it solely to the province to allocate resources, the federal government is allowing B.C. to impart the costs of lost funding onto the most vulnerable and marginalized groups. The decentralization, individualism, and cost/benefit framework of neo-liberalism has transformed the way Canadians view the state's responsibility to its citizens.³⁴ As a result of the new challenges that neo-liberalism has brought to Canadian federalism, it has become even harder for those falling outside of the system to have their voices heard. It is important that policymakers become aware of these connections in order to sustain equality among all Canadian citizens.

Political Influence

Not only is equality of opportunity being eroded for Native women in B.C., but their ability to influence the government at all levels and address the systemic roots of their problems is also under attack. For example, in 2006 the operating budget of Status of Women Canada suffered a reduction of almost 40%, and although much of this funding has since been reinstated, funding to many advocacy, lobbying and research groups was permanently lost.³⁵ The restriction of advocacy funding further closes the means by which Indigenous women can have their interests represented and heard in government.

Neo-liberal policies revolve around a framework that denies the diverse social positions of distinctive identities. Some Conservatives have claimed that categorizing individuals on the basis of race, gender, religion, etc. is offensive or oppressive, yet they have continued to espouse a narrative that discounts true oppression based on these factors.³⁶ As Alexandra Dobrowsky explains, “interest shapes identity, and vice versa” meaning that by denying interest group advocacy on the part of First Nations women, we are fundamentally denying that their identities are based on gendered and racialized experiences.³⁷ Iris Marion Young also astutely pointed out that “Liberal individualism denies the reality of groups.”³⁸ Without the recognition of women or First Nations as groups, their collective interests are lost in the individually focused discourses that deny systematic oppressions or shared circumstances based on group belonging.³⁹

Currently, only five out of the 305 members of the federal House of Commons are of Indigenous origins, and only two of these are women.⁴⁰ Additionally, in the 2006 elections the Conservative government only fielded 38 women out of 308 candidates (12.3%), and only 11% were given cabinet positions in the new government.⁴¹ Because neo-liberalism sidesteps group/collective identities and claims to represent everyone’s

interests equally, the Harper government runs the risk of alienating and marginalizing a great deal of Canadians who see their identities as being more than disconnected individuals.⁴² In light of current economic difficulties, voters are likely to appreciate the turn toward liberal fiscal policy by the Conservatives, however this shift may fail to take into consideration the cost to social programs that contribute Canadian identity.⁴³

Advocacy for women's and First Nations interests goes beyond representation in political parties or "interest groups", and penetrates both public and private spheres, education and economics, and activism and politics.⁴⁴ Advocacy groups are so wide ranging in their pursuits of equality, recognition of collective identities and social justice, that removing their funding fundamentally endangers the roots of feminism. In denying advocacy, lobbying and research groups funding, the Conservative government managed to successfully 'other' the women's and First Nations rights movements from mainstream politics by deeming their causes no more than 'special interests' and attempting to undermine their right to exist in formal politics.⁴⁵

In 2006, the Harper government's former Minister of Heritage and the Status of Women, Bev Oda, was quoted as saying, "we have to understand that if women are continuously told that they are not equal, they will continue to believe that. We say that everyone in Canada is equal."⁴⁶ The statement made by Minister Oda exemplifies a neo-liberal approach which fails to recognize not only the steps yet to be taken in terms of women's equality, but also the plight of all those who do not fit neatly into distinct categories of oppression, notably women of colour, Native women, non-heterosexual women and the disabled. Oda's statement is also significant in that it shows that having women in power does not always equal the representation of women's interests.⁴⁷ Thus the need for extra-parliamentary sources of representation such as interest, lobby and activist groups becomes even more apparent.

Violence

Finally, in addition to suffering greater rates of unemployment, lower incomes, less representation, and greater health problems, Indigenous women in Canada also face a much higher proportion of domestic violence.⁴⁸ British Columbia has the highest reported incidence of violence against women of any province in Canada.⁴⁹ Domestic violence in First Nations communities has an added layer of complexity because of the racism and abuse suffered by the community as a whole, a fact that cannot be discounted when attempting to uncover the roots of violence against Indigenous women. As Brownridge explains,

It is possible that Aboriginal men have not only internalized the devaluation of women but that this operates in a context where they themselves feel devalued by society. To feel some value in the society in which they find themselves, they may have adopted White devaluation of women and seek to attain a sense of self-worth through having power over their partner.⁵⁰

In this way it is possible to see how, by refusing to acknowledge First Nations people as having a distinct group identity, neo-liberalism has encouraged policies that fail to reflect their historically disadvantaged positions in society.

The status of First Nations women in their own communities has been jeopardized by a history of devaluation since first contact. In the past, only male First Nations leaders were recognized and consulted with. This trend, along with the narrative of ownership of women that existed in the Indian Act until the late 1980s, has allowed a discourse in many First Nations communities that has allowed band leaders and elders to deny the prevalence or seriousness of violence against them.⁵¹ Moreover, neo-liberal discourses of personal responsibility place the blame on First

Nations women for their failure to maintain healthy relationships or provide for their own security. Examples of abuse are then used as illustrations of the inability of First Nations governments to uphold provincial policies, thus undermining the potential for greater autonomy for First Nations people.⁵²

The hesitation and skepticism surrounding First Nation's self-government serves to discourage women from coming forward about abuse. As is often the case, Native women must choose between their culture and their personal safety in order to retain acceptance in their communities.⁵³ As Gotell explains,

Any adequate response to family violence must encompass a broad range of interventions including: expanded social welfare and child care programmes to provide women with economic independence; increased funding for social housing, second stage housing, and job training; increased and stable funding for shelters and crisis centres, and ...culturally appropriate services for aboriginal and immigrant women, etc.⁵⁴

Hence, cuts to social welfare programs and personal responsibility discourses in government have not only made help more difficult to attain, but they have also discouraged women from coming forward.

Conclusion

In conclusion, the implementation of neo-liberal policies, while arguably successful economically, has been detrimental to the First Nations women of B.C. and Canada. Because physical barriers such as violence and health problems caused by poverty facilitate exclusion from the public realm, the denial of social rights to First Nations women has contributed to their disenfranchisement in the political arena. Moreover, because neo-

liberalism refuses to acknowledge the worth of private contributions, their lack of economic contributions coupled with the decrease in advocacy groups has directly lessened their ability to access and advocate change. Although the topic of discriminatory policies toward First Nations women could constitute a much larger and more in-depth study, in this paper I have outlined just four important aspects of the ways in which First Nations women are unfairly targeted. I feel that the issues of poverty, elimination of social services, lack of political representation, and the prevalence of family violence are all inextricable consequences of the ways in which the forces of patriarchy and neo-liberalism are being expressed in Canada today. It is time to give First Nations women a voice, both within their communities, their provinces, and the Country.

We as Canadians cannot allow injustice and exclusion to continue by refusing to acknowledge our own part. By challenging our own biases and seeking to uncover the true consequences of the dominant economic paradigm, the realities of neo-liberalism on the Canadian political landscape become glaringly clear. Canada, as a whole, must recognize that we are not made up of individuals, but of groups and nations and communities, and that sometimes, individual rights lead to systemic wrongs.

Notes

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Conflicting Policies

The Chinese Yuan, the WTO, and the IMF

Christopher Gillespie

On December 11, 2001 China joined the World Trade Organization (WTO).¹ What was once heralded as a diplomatic victory and a time of economic reformation for China² has become a diplomatic incident for other trade giants, one that even the International Monetary Fund (IMF) is trying to defuse.³ The United States Congress has gone so far as to introduce an act that would allow the United States to place duties on goods coming from countries with under-valued currencies.⁴ The question becomes one of how a pegged-currency is a threat to the current liberal trade regime. To understand this problem, one must examine the key principles of the WTO and IMF, the effects that a pegged-currency like China⁵ has upon a country such as the United States and then evaluate whether the principles of the WTO and IMF are undermined by the actions of China.

Before one begins to examine this complex topic there must be an understanding of how China operates its foreign exchange policy. The core principles around a pegged-currency system involve the Central Bank attempting to reconcile monetary and exchange rate policies. In a simplified form, this is done by the Central Bank through selling bonds to reduce its domestic economic footprint when facing “excessive” capital inflows. When “outflows” become excessive the Central Bank will purchase bonds, increasing the domestic element of its monetary base.⁶ It is through these types of measures that the Chinese Central Bank ensures that the yuan maintains its peg to the United States dollar (USD). A particular preference of the Chinese Central Bank is the purchasing of United States Treasury bills, effectively holding the majority of the US national debt until very recently.⁷ To purchase these bills, the Central Government in China must convert yuan

into USD, thereby increasing the amount of yuan in general circulation and decreasing the amount of USD available. This decreases the value of the yuan and increases the value of the USD through the basic laws of supply and demand.

The effect of having a low currency compared to the United States makes China's goods more cost-effective due to relatively low labour costs. This has caused an exodus of labour-intensive industry and jobs from the American economy.⁸ Despite this, the United States cannot complain that China is violating the WTO's rules against dumping⁹ as it is their currency creating this phenomenon, not a wilful act of exporting goods below cost. The implications of this will be discussed below.

Nicholas Lardy points out that China had little reason to revalue its currency prior to 2003.¹⁰ He argues that the current leadership is misguided in its understanding of "China's last macroeconomic cycle" and implies that the leadership within the government should listen to the advice of its Central Bank in allowing greater flexibility to the currency.¹¹ This advice was given in 2005 and could have done much to avoid the current circumstances.

The WTO and IMF

Established in 1995 from the principles of the General Agreement on Trades and Tariffs (GATT)¹², the WTO is the 'regulator' for international trade. It is founded upon the principles of treating other nations equally, treating foreigners and locals equally within ones domestic borders, lowering trade barriers, providing predictability to the system, promoting fair competition, and encouraging economic development and reform.¹³ The key principle to examine in the instance of China's currency would be the principle of promoting fair competition.

The WTO recognizes that trade issues can be complex, but it has a mandate to strive towards its goal of promoting “open, fair, and undistorted competition.” This is generally done with the above principles of non-discrimination, but also through anti-dumping regulations. As described in the introduction, this is not what is occurring within the United States. Instead, the US is being flooded by cheap goods due to a relatively low currency. There are no provisions within WTO regulations to deal with a market flood of this type. This has forced the United States to move towards enacting trade protections that may or may-not be in violation of the WTO’s rules on punitive measures.¹⁴

The other core international institution that has strong influence over trade and finance is the IMF. While the main goal of the IMF is to provide policy advice, research, and loans to member governments,¹⁵ there are key responsibilities outlined for the membership. All members must agree to a series of ‘articles of agreement’ to which they are expected to adhere.¹⁶ It is an examination of Article IV that reveals a reference to the manipulation of the financial markets with the intent of preventing a balance of trade. According to this article, preventing a balance of trade or acting with the intent of gaining an “unfair competitive advantage” is a forbidden practice by member states.¹⁷ This is important when assessing the need for International bodies to act in defense of either China or the United States.

As the cornerstone of the current trade regime, the WTO and IMF often have to work in close conjunction with each other. According to the IMF they regularly consult one another and suggest that this level of coordination will continue to grow, as their interests are common.¹⁸ Despite this level of coordination, scholars rarely seem to research the organizations in conjunction with each other. One scholar will tend to view occurrences within the purview of the WTO¹⁹ or the IMF.²⁰ It is important to recognize the importance of their connected work in the context of

the international trade regime in order to effectively evaluate the outcome of this situation.

Trade Surplus and Currency Valuation

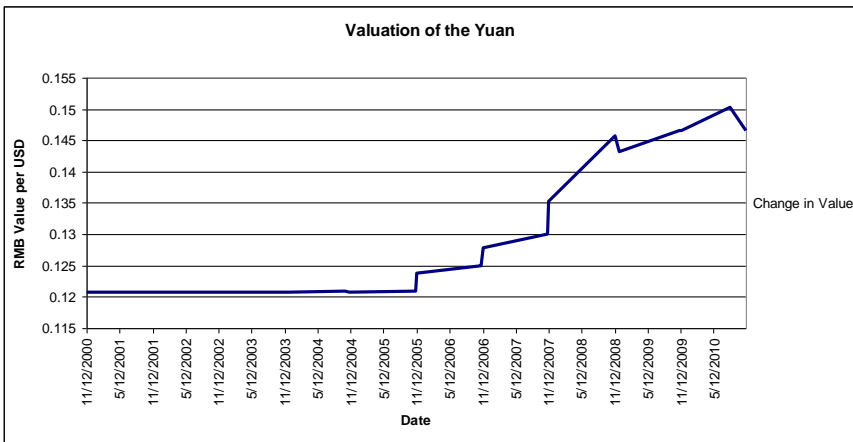
With China's change in market standards in the late 1980's and early 1990's, the doors to their markets began to swing open, inviting further foreign direct investment (FDI). Upon joining the WTO in 2001, China's ability to attract FDI increased, allowing them to export larger quantities of goods to countries such as the United States. As seen in Table 1 below, China's trade surplus was growing steadily with the United States until 2000, when there was a slight drop. However, upon joining the WTO in 2001 one starts to see a sharp increase in the amount of trade surplus being generated by the Chinese state. While the chart shown below only goes until 2004 with an estimated trade surplus of \$160 billion, this figure rose to over \$268 billion in 2008, dipping back down in 2009 with the economic recession.²¹

TABLE 1 ²²



Upon reviewing the data of the Chinese Yuan compared to the United States Dollar over the past decade since China joined the WTO, a pattern of relatively low valuation emerges when placed in comparison to the trade surplus with the United States. The total value of the Yuan has only risen 0.029474 compared to the United States Dollar since joining the WTO in 2001. Upon inspection China did not allow its dollar to rise in value at all between 2001 and 2005 and it has only been within these past four years that value has been added, however minimal.

TABLE 2²³



When one considers the massive trade surplus from the United States, within the framework of liberal economic theory, China’s Yuan should be valued much higher than it is within the floating market. Various internal pressures, such as low domestic interest rates, would have either pushed the value of the currency up or eliminated the trade surplus. However, this has not occurred under China’s highly regulated financial markets, helping to create the imbalance one sees within the system.²⁴

Assessing the Situation

Having established that China pegs its currency and examined the roles that the IMF and WTO play in regulating trade, it is important to analyze whether China's policy violate any of the rules of international trade, as suggested by countries such as the United States. When creating such a judgment it is important to understand that any change from the status quo would have an impact on both China as a domestic market and on the international system as a whole.

As discussed within the section regarding the WTO and IMF, member states of the IMF are forbidden from manipulating exchange rates for the purpose of gaining an unfair competitive advantage. With the Yuan being undervalued by People's Bank of China (PBC), compared to its assumed market value, China is creating an atmosphere of unfair competitive advantage within the labour and trade market. This is in violation of their agreement as a member of the International Monetary Fund.

Despite this, the IMF has been hesitant to enact a currency accord to work towards adjusting this imbalance.²⁵ This has led world leaders within the G20, such as South Korea, Japan, and the United States, to work towards creating this accord instead. This is not to say that they are undermining the authority of the IMF, as G20 leaders have promised that the accord would include amending some of the organizations functions, boosting its credibility.²⁶

Within the WTO there are no regulations regarding the treatment of exchange rates, however members are required, as a basic principle, to promote fair competition. One must examine the PBC behaviour in this matter and see if it falls within the guidelines of promoting or hindering fair competition. According to Anthony Makin, China's foreign exchange has become something akin to trade protection.²⁷ However, this is not entirely

accurate within the context of the WTO since the organization has no regulations against currency manipulation. A potential violation is the recent currency bill introduced to the United States Congress, which China has threatened to take to the WTO.²⁸ If this were to occur, the United States could conceivably complain to the IMF over China's currency policy, creating two conflicting rulings from the leading bodies within the international trade regime. Regardless, this issue is presenting a destabilizing effect to that regime. In this case it is possible that Western governments would find themselves in a situation where action against China is seen as legitimate, due to their own faltering economies.²⁹ This would not be in China's best interest. To be excluded or punished for their actions within the world markets would invite domestic economic disaster and strained international relations, in a time when the regime is attempting to grow.

The solutions to China's valuation circumstances depend heavily on how quickly and decisively the government chooses to act. Anthony Makin presents the idea that China could alleviate the concerns over the trade surplus through a small currency alignment, as well as increasing public spending on initiatives, such as health and education. Makin implies that these two items would go a long way to correcting the trade-imbalance problem.³⁰ He does emphasize the need for any changes to be made incrementally, due to the weakness of the banking sector.³¹ However, this is not the sole potential solution.

John Williamson from the Institute for International Economics suggests that China should consider, in addition to allowing its currency appreciate, switching to a consumption-based economy. He notes the fact that many Chinese families tend to save a significant portion of their incomes. Encouraging them to spend more, instead of saving more, would help to mitigate the negative implications of a rising value in currency.³² The general consensus amongst economic experts, even from within China, seems to be that the Government of China needs to move towards a

more floating currency or risk a destabilization in its trade relations as other countries, including the United States, begin to diversify.

Williamson's opinion is expanded upon by Nouriel Roubini at the Stern School of Business in New York. He argues that China's reliance upon exports, without building an internal consumer culture, will create larger consequences during economically turbulent times³³. This is particularly true if the current economic crisis continues to extend into the foreseeable future, as Roubini is predicting a second dip to the recession in the near future.³⁴ Another point he argues is that, not only is China placing their economic situation in the hands of the global markets, they are also creating massive losses for themselves financially. As the value of the yuan increases, the value of the foreign bonds already held diminishes. Roubini projects that, from 2006, the Chinese government could experience losses in upwards of \$600 billion on a \$2 trillion bond due to the appreciation of its own currency.³⁵

Conclusion

China's decision to continue to peg its currency rather than letting it float is a significant challenge for the international trade regime. It challenges the articles and conventions of two international organizations, the WTO and IMF, and threatens to create a diplomatically sensitive issue. What the Chinese government needs to recognize is that, not only will unpegging their currency relieve international concerns and tensions, but it is the most financially prudent course of action during the current economic climate; especially given the regime's present goals of continued growth.

A significant number of international economists agree that the Yuan is under-valued and that this is creating a number of issues within the international markets. An eventual correction of the trade imbalances with China will need to be solved and this

will likely occur in conjunction with an appreciated value of the Yuan. The Government of China needs to recognize that working towards bringing their currency into the floating market, along with realigning their economy so as to reduce excessive trade surpluses, is not an act of weakness in caving to Western powers but would serve their government's interests in promoting economic growth within their own borders, in addition to bringing further stability to the international markets. Appreciation of the yuan would also help the Chinese government in weathering the current financial crisis and avoid massive financial losses on its foreign holdings.

It is easy to focus solely on China but the lessons from this situation for the international trade regime should not be overlooked. Although presently two separate international bodies, the IMF and WTO have similar goals when it comes to regulating the fair competition of international trade. When rules and regulations are overlooked or ignored by a body this creates the potential for conflict. Both organizations should consider coming together to examine their articles and regulations in conjunction to ensure they compliment, instead of conflict, with each other. This would serve the purpose of bringing greater stability to the international trade regime.

Notes

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A Billiton Dollar Investment

Canada and the Global Regulation of Foreign Direct Investment

Alex Monin

In what would have been the biggest foreign takeover in Canada, BHP Billiton (BHP), was denied the acquisition of Canadian Potash Corp. in November, 2010. This has been the second takeover denial since 1985, when the Investment Canada Act (ICA) was enacted (CTV, 2010). Although there is a divergence of opinion on the impact of denying a nearly 40 billion dollar investment, the question of whether the takeover evaluation criteria serve their purpose is asked by all, including the Minister of Industry Tony Clement who authorized the denial.¹ Foreign direct investment (investment, FDI) can be defined as a transfer of assets from one country to another for the purpose of producing profit.² In BHP's case, Canada would have had access to imported capital in exchange for profit collected by BHP shareholders through the share ownership of Potash Corp. Although FDI is not without negative externalities, The Conference Board of Canada, joined by a substantial number of economists, disregard them as "phantom fears," describing the overwhelming benefits of FDI including job creation, technology import, and increased tax revenue.³ In light of overall benefits and support the take-over had, this paper will seek to understand why Clement denied the deal. After a short overview of the attempted Potash takeover, this paper will describe the current political economy issues in Canada, which as this paper infers, were largely responsible for Clement's decision. This paper will further examine how the ICA is structured, and argue it is purposefully vague as a defense mechanism against risks associated with FDI. This paper will finally examine the FDI risks and summarize why they are not currently addressed on a global multilateral level.

In November 2010, Australia-based BHP was denied a buyout of the majority of Saskatchewan-based Potash Corp. shares. Under the ICA, FDI can be denied if it does not “benefit Canada’s long term economic interests,”⁴ otherwise known as the ‘net benefit’ test. During the existence of ICA, out of 1,639 cases brought forward for approval, this is the second takeover to be denied.⁵ The Minister of Industry Tony Clement is legally empowered to interpret and enforce the act.⁶ Certain critics blame Clement for basing his decision on concerns over civil backlash and securing Conservative ridings in Saskatchewan for the next election, rather than evaluating tangible economic benefits of the deal.⁷ The issue was exacerbated by the fact that no rationale for the decision was provided at the time. On November 15, BHP officially withdrew its offer claiming ‘net benefit’ section under ICA went against “creating shareholder value” and was therefore, no longer economically feasible.⁸ Apart from a nearly 40 billion dollar investment, the takeover would have provided Canada with nearly 400 million for infrastructure development, and would have increased current employment at Potash Inc. by 15 percent in the next five years.⁹ These recent events bring forward the question: “exactly how do foreign takeovers not benefit Canada’s interests?”

The ongoing court case brought forward against U.S. Steel by Tony Clement may very well explain Minister’s hesitation, and eventual refusal of the Potash takeover. In 2007, struggling Hamilton-based Stelco agreed to be bought out by U.S. Steel for just over a billion dollars.¹⁰ By agreeing to pay off over 800 million in Stelco’s debts, U.S. Steel would “re-establish Stelco as a competitive steel company.”¹¹ Although ICA undertakings (legal obligations undertaken as part of the takeover) specified by Clement were never made public, U.S. Steel agreed to maintain employment levels, production levels, and Stelco’s pension obligations.¹² Then, in October 2008 amid the recent economic downturn, U.S. Steel shut down most Hamilton and Lake Erie mills, affecting 1,500 jobs.¹³ The company argued the collapse in demand for steel “left it no choice.”¹⁴ The company argues that the

“future of the entire company was in jeopardy if it kept ... Canadian mills running.”¹⁵ In May 2009, after requesting U.S. Steel to justify cutbacks, Clement said he was not satisfied with the justification for non-compliance.¹⁶ The formal prosecution case that was launched in July of the same year, is still open and untried.¹⁷ U.S. Steel faces potential prospects of a nearly \$15 million fine under the ICA.¹⁸ In 2010, U.S. Steel was once again under fire after locking out 900 Hamilton workers for failing to come to an agreement on a pension contract. Ken Neumann, Steelworkers National Director, described U.S. Steel’s net benefit as “plant shutdowns, production cuts, lost jobs and labour disputes.”¹⁹ Although U.S. Steel was the only company prosecuted for ICA non-compliance, both Brazil’s Vale Inc. and Switzerland’s Xstrata cut over a thousand jobs in their Canadian subsidiaries during the fall of 2008, breaking their employment level undertakings.²⁰ These recent controversies help understand Clement’s decision; however, it is important to examine the ICA provisions in more detail.

The ICA emerged in Canada in 1985 with Brian Mulroney’s optimistic statement “Canada is open for business again.”²¹ Its predominant purpose was to increase the flow of investment to Canada by streamlining the process to make it easier and more attractive. The monetary threshold for official takeover review was raised and the process was made more timely. The criteria for determining the ‘net benefit’ are outlined in Section 20, and divided into six subsections. Further specification is provided such as effect on industry, technological development, and competition.²² Lalonde explains that these factors are considered as a whole, and given “different weight in different circumstances.”²³ He concludes that the process is flexible to allow its application to be tailored to fit each scenario, as opposed to sweeping formulaic application.²⁴ The highly partisan nature of the review was criticized by Jack Layton as “lack[ing] transparency” which, as MDC Partners CEO Nadal further voiced “increase[d] uncertainty among investors.”²⁵ In response, Harper acknowledged that the act

needed to be reviewed. Clement followed, saying he was prepared to address the claims against the lack of procedure transparency.²⁶

Jim Stanford, Canadian political economists critical of the upcoming review. According to him, the lack of transparency plaguing the ‘net benefit’ test has given the government “enough leeway to veto any proposed takeover.”²⁷ A premise that the vagueness of the act is a political defense mechanism is sensible, after considering the burden U.S. Steel put on the Canadian government. Stanford explains that after the 2007 refusal of MDA’s space division sale, ICA was also updated, but only to the extent of adding “national security” as a “post-hoc justification.” He concludes that the proposed review is an “intellectual cover” and, instead of “play[ing] ‘wordsmith,’” a more honest examination needs to take place.²⁸

Empirical observation of recent FDI policies in the U.S. seems to support Stanford’s position. The U.S. regulation of investment began with the formation of the Committee on Foreign Investment in the United States (CFIUS) in 1975, which was designated with monitoring and implementing U.S. policy concerning FDI.²⁹ In 1988 the Exon-Florio Amendments (EFA) were passed which gave the president the power to block FDI if “the foreign interest ... action ... threatens to impair the national security.”³⁰ The president delegated this authority to CFIUS which, from then on, was responsible for determining FDI’s potential threat to U.S. national security. Enforcement of EFA was largely discretionary given the term ‘national security’ was never actually defined.³¹

The Foreign Investment and National Security Act of 2007 (FINSAs), set out to make the FDI review process “more transparent and predictable without making the business climate less friendly to foreign investors.”³² FINSAs included the introduction of specific standards in the FDI review process which gave CFIUS a significantly wider domain of application, including

areas such as “critical infrastructure and ... technologies.”³³ Critics of FINSA argue that CFIUS’ newly broadened domain now encompasses over 65% of U.S. business sectors as a matter of national security.³⁴ While the U.S. evaluated FDI on national security grounds instead of ‘net benefit,’ its designated purpose was clear: when increased transparency no longer allowed significant leeway in regulatory policy, the policy was further altered to be as broad and all-encompassing as possible.

This pattern of behavior can be further applied to Canada’s FDI regulatory framework. In the absence of a developed regulatory system, the Canadian government pursues vague FDI policy, which allows it to reject specific cases of FDI without stating the rationale explicitly. This is necessary as, such as in the case of the U.S. Steel, the effect of FDI cannot be effectively evaluated beforehand. Multinational corporations (MNC) do not always follow through on their commitments implicating the host government into prolonged legal action. Further accusations of preferential bias and partisan politics exacerbate the issue.³⁵ Because ICA is intentionally vague, companies struggle with conducting regular business as they cannot account for how ICA will affect them. U.S. Steel’s lawyer Barrack raised a yet to be answered question regarding ICA: “how do I behave in an acceptable way?” Barrack further called the act flawed as it does not describe how investors can justify non-compliance.³⁶ In the current situation, both sides find themselves at a loss.

Vague FDI regulation results in a system with an information asymmetry problem. Prosecution risks imposed on MNC, like the U.S. Steel court case, threatens monetary profits. Inability to properly plan FDI profits further raise the cost of investment. In the end, some prospective FDI which would benefit both sides does not take place, as risks associated with non-definitive regulation make the costs too high for one of the sides – the MNC. Can this information asymmetry problem be reduced?

Removing the information asymmetry would require establishing a clear regulation procedure but a number of changes would need to occur for the government's support. Examining current FDI challenges, three aspects of FDI regulation need to be established for the possibility of regulation clarification. First, precise and elaborate entrance criteria to legally account for the majority of possible hindrances and loopholes would give the government a transparent legal output through which it could reject FDI it does not support. Second, an established and 'preferable' code of conduct for MNC to follow (for example, general acceptance of union authority) would reduce the risk of costs arising from unexpected and unpredictable MNC behavior. Third, a standardized penalty determination and enforcement system is needed to make infraction prosecution inexpensive and timely.

The current international regime for investment regulation can be described as fragmented, uneven, and decentralized.³⁷ Lacking a cohesive, multilateral system, it is defined by over 2,000 highly divergent bilateral investment treaties (BIT) between different countries.³⁸ First FDI challenge, establishing clear entrance criteria, can theoretically be achieved through the current system. For example the investment provisions of the Free Trade Agreement in effect since 1987, although leaving much to be desired, established equal, non-discriminatory treatment for the U.S. and Canadian investment.³⁹

Two other FDI challenges are problematic to address in the current system: setting a corporate code of conduct, and standardizing penalty enforcement. A preferable, universal code of conduct cannot be established as there is no universal definition of 'preferable,' while there is a possible consensus on what constitutes favorable and unfavorable behavior, BIT value various MNC behavior to different extent; as a result, host countries still face a high risk of 'unpreferable' and costly MNC behavior. Standardized penalty determination and enforcement system is further unfeasible in a bilateral agreement. An establishment of a

separate body is far too costly, and domestic legal systems, as proved to be the case with U.S. Steel, cannot be easily universalized to act as an international court. To remedy two FDI challenges outlined above, a universal, multilateral investment regulatory agreement needs to be in place. Further, this paper will examine the development and ultimate failure to establish such an agreement, and the reasons behind it.

Multilateral Agreement on Investment (MAI) was the multilateral investment regulatory agreement developed by the Organization for Economic Cooperation and Development (OECD).⁴⁰ It was discussed from September 1995 to its abandonment in October 1998, after France decided to no longer participate in the discussion (1998). The MAI attempted to establish a comprehensive, multilateral framework on investment by “setting clear, consistent and transparent rules on liberalization and investor protection.”⁴¹ The MAI’s strength in particular, came from its ‘top down’ approach. If every country acceded it as was planned, nearly all actors and activities would have been covered.⁴² The MAI, would have enforced global national treatment: for example discrimination between foreign and nationals investors would be forbidden.⁴³ It would further establish an arbitral panel with binding resolution powers.⁴⁴ The MAI had a strong potential of establishing a multilateral code of conduct and penalty enforcement mechanism, why was it abandoned?

Although failure of the MAI involved a diverse multitude of factors, two strong opposing forces played a key role: international NGOs and developing countries. Developed in a closed OECD forum the MAI came under fire as NGOs criticized its lack of transparency. By 1996, the MAI faced significant opposition from environmental and human rights non-governmental organizations, claiming the pro-business agreement failed to acknowledge labor and environmental regulations.⁴⁵ Overwhelming number of grassroots movements joined the NGOs in criticizing MAI for failing to account for the interests of the developing nations.

Unwilling to displease electorates, European governments began to withdraw from negotiations, with France's resignation marking the end.⁴⁶ Why did some developing countries oppose the MAI?

Although a multilateral FDI agreement offers developing countries a mutual economic benefit by reducing competitive price undercutting and maximizing profit, it is offset by the increased sovereignty cost due to extended foreign ownership.⁴⁷ Crystal isolates two economic outlier groups in the developing world: East Asia that is very attractive for FDI; and parts of Africa that does not attract significant FDI.⁴⁸ The former stands little to gain from multilateral regulation as it already occupies a privileged position, and the latter is indifferent to FDI concerns. AFL and UFL groups will refuse the *fait accompli* imposition of the agreement as it does not benefit them economically but does impose sovereignty costs; the remaining developing world cannot establish a sustainable economic cooperation without their involvement, as artificially high profits enjoyed by non-members will attract competition which will break apart the cooperation.⁴⁹ In short, given the current economic structure of the developing world, a universal multilateral agreement is not enforceable. As the latter two criteria (universal code of conduct and standardized penalty enforcement) cannot be currently satisfied in the *ad-hoc* international arena, it is unlikely that any significant change in FDI policy will occur.

In conclusion, this paper introduced a premise that the ICA is purposefully vague to protect itself from FDI it cannot dismiss for explicit legal reasons. The paper further outlined the current investment regulation regime, and concluded that it is constrained by the vagueness of the act, further elaborating that both MNC and Canada would benefit from its clarification. Proposing criteria that would reduce FDI risks and allow Canada to clarify ICA, the paper found that some form of multilateral investment regulatory agreement is necessary to fully realize the criteria it set out. By analyzing the structure of MAI, followed by the reasoning behind its failure, this paper came to the conclusion that, given the current

composition of the developing world, a multilateral investment agreement is not feasible. Assuming no significant advancement in the direction of a multilateral FDI regulatory agreement takes place, the upcoming review of the ICA is unlikely to introduce significant changes as the prospective FDI threat posed by BHP Billiton has not been addressed.

Notes

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Realist Liberalism?

A Comparison of the Regional Development Schemes behind the Lockheed Martin's F-35 and the Eurofighter Typhoon

Daniel Schade

Consumers seeking the latest running shoes, lipstick, electronics, or virtually any other merchandise will no doubt appreciate the global effort and fiscal benefits of international markets and global supply chains. However, when states as consumers are interested in procuring the latest high-value military capital, the methods of procurement and development are much more complex. Of particular interest is the burgeoning aerospace industry, whose products have become so exceedingly expensive that single states - not even the United States – cannot independently afford to absorb the cost of production. Instead, strategic global partnerships have been forged to develop military assets like fighter jets, whose price tag commonly exceeds \$100 million per unit. At first glance, this cooperative, international approach to defense procurement mimics the very same liberalized, globalizing economies that bring cheap consumer goods to market; in fact, it is the domestic tax-payer who will reap the savings of cheaper public goods. If this were true, it would shatter the realist conception of defence procurement where states guard their military assets and industry against exploitation by adversarial nations. In pursuit of a more thorough explanation of global defense partnerships, this analysis will investigate the domestic, regional, and international politico-economic consequences of the Eurofighter Typhoon and the United States' Joint Strike Fighter Program.

The End of the Cold War and the "New Regionalism"

The end of the Cold War saw the emergence of American military and economic hegemony on the global stage. In the years following the fall of communism, structural realists predicted the rise of European and Japanese military economies designed to challenge, or at least counter, this American hegemony.¹ While no single state rose to prominence, many powerful regional trade areas emerged and strategic free trade networks like the North American Free Trade Agreement (NAFTA), the Southern Common Market (MERCOSUR), and the European Union (EU) became bastions of international trade and commerce.²

While intra-state trade in goods and services flourished, national defense industries struggled to find new value in the face of the peace dividends of the 1990s. Dual-use technology, or the development of military hardware that had value in civilian applications, became the focus of many security firms.³ However by the late 1990s, deep cuts in national defence budgets around the world left thousands out of work. In the U.S., states that once housed large defense firms suffered unemployment rates that were two-and-a-half times the national average.^{4 5} Further compounding the industrial effects of de-militarization was a fundamental re-orientation of the economy towards service-based commodities.⁶ For its part, the U.S. Department of Defense went to great lengths to revive the industry by providing incentives to firms that actively work with civilian partners in the development of emerging technologies.^{7 8}

As national defense budgets receded throughout the 1990s, so too did the number of independent, security sector prime contractors thanks largely to a process of international mergers and acquisitions.⁹ In the United States alone, a handful of prime contractors currently remain of an original twenty in the early 1990s.^{10 11} The number of domestic suppliers of small arms, grenades, and long-range bomber aircraft rapidly decreased, often

to the point where only one single supplier existed.¹² Apart from the potential for monopolistic production, this industrial aggregation produced a complex “hub and spoke”¹³ network of industrial development where prime contractors sub-contract simple production tasks to domestic or international partners, while maintaining key final assembly tasks within their domestic purview.¹⁴

The European experience with economic de-militarization has been considerably more successful than that of the United States; however, it is also considerably more complex in its understanding. Part of Europe’s success can be attributed to an already dual-focused, second tier defense industrial sector able to quickly and efficiently transfer technological gains from the military sector into civilian applications.^{15 16} During Cold War, Western European states spent considerably less on defense per annum than their American counterparts, thus making the transition back into peacetime economies much less drastic.^a Equally important to European industrial re-orientation was the existence of broad social welfare nets. In Germany, for example, firms that could not adjust to a more civilian orientation failed, as the government’s *laissez-faire* approach to “firm and community adjustment”¹⁷ was backed-up by significant welfare programs to displaced workers. However, great care must be taken when discussing the European aerospace industry as a unitary actor, for it most certainly is not. Any such analysis must take into consideration the fractious nature of European defense policy and the absolute freedom that European Union (EU) member states exercise in developing domestic arms industries. While the EU remains a relatively open zone of mobile trade, we must remind

^a During the period from 1988 to 2000, the four major Eurofighter states reduced their average annual defense spending (as a per cent of GDP) by only .26 per cent, compared to 2.5 per cent in the United States over the same period. “SIPRI Military Expenditure Database” *Stockholm International Peace Research Institute*. <http://milexdata.sipri.org/>

ourselves of the exceptional nature of defense materiel within these zones.

Defense networks like those surrounding the F-35 and the Eurofighter are not outcomes of free-trade legislation. In fact, international trade regimes explicitly exempt governments from abiding by free-trade regulation when it comes to the production and acquisition of defense materiel. The European example below clearly illustrates member states' ability to insulate domestic defense firms from outside competition with tariffs or protections:

...any Member State may take such measures as it considers necessary for the protection of the essential interests of its security which are connected with the production of or trade in arms, munitions and war material; such measures shall not adversely affect the conditions of competition in the common market regarding products which are not intended for specifically military purposes.

- EU Article 296 (1)(b) formerly a. 223 of the
European Community Treaty

Similar language can be found in the North American Free Trade Agreement.¹⁸ Even the World Trade Organization (WTO) recognizes states' rights to insulate industries relating to domestic security.¹⁹ While this paper explores the Eurofighter as a European outcome, it is not a direct product of European integration and should not be referred to or considered as such. It can, however, be considered a fine example of selective regional cooperation taking place under the auspices of the EU economic umbrella.

Finally, aerospace materiel is often among the most costly, technologically intensive, and politically sensitive assets that a state may acquire, and therefore remains an intriguing product of global patterns of economic development. Tracing the production

and procurement of combat aircraft offers valuable insight into the regional norms inherent in the economic relationships between allied states and sub-state actors. The F-35 and the Eurofighter can be used as comparable case studies as both are expected to carry out a similar combat role and both have had a profound effect on economic and defense relations within their respective development regions. Another important factor in studying aerospace assets is the sheer time it takes to develop these aircraft from conceptualization to the production line. With design and pre-production taking well over a decade in some cases, these programs often outlive successive governments, thus making them more indicative of longer-term *regional trends*, rather than the political trend of one administration over another. Those with more intimate, technical knowledge of these two programs may cite the technical differences that set these two aircraft apart and thus claim this analysis obsolete by virtue of an asymmetric comparison.^b This line of argument is, however, technologically deterministic, and this analysis advances the commonly-held notion that the most pertinent military weapons system is in fact the state military entity as a whole, with doctrinal and procurement actions legally shaped by civilian preference via the decisions of elected officials in conjunction with military planners. The technical virtues of one aircraft over another is ultimately irrelevant and, for the purposes of this paper, both will be considered as little more than a common ‘widget’ of production.

The Eurofighter Typhoon

Designed in the closing years of the Cold War, the Eurofighter Typhoon was intended to replace aging, largely

^b Within aviation circles, fighter aircraft are classes into five generations, with each successive generation marking the introduction of paradigmatic technology that may not have been available to previous generations. The F-35 is a fifth-generation fighter aircraft, while the Eurofighter remains a 4.5th generation aircraft. One of the defining elements of the F-35 is its limited low-observability (stealth) design, a feature not incorporated into the Eurofighter.

American-built fleets of aircraft. While the idea of a new, all-European fighter dates back to the early 1970s, the multinational holding company now responsible for its production, *Eurofighter Jagflugzeug GmbH*, was struck in 1986 and includes firms representing Germany, the United Kingdom, Spain, and Italy.²⁰ By design, the Eurofighter program delivers benefits to member states in proportion to early investments, with four final assembly plants in each of the partner states locations. Interestingly, final acquisition and management of the aircraft and its sub-systems are governed by NATO on behalf of the member states' Air Forces. Though there are many reasons for an all-European fighter, GmbH makes quite clear the need for "...an independent European combat aircraft industry allowing independence from the USA."²¹

The massively complex organizational structure of Eurofighter GmbH, compared to the small number of aircraft produced, is a telling sign of the capital required to produce a fighter aircraft and the dispersal of that capital across a number of European prime contractors. Within the airframe consortium are a number of transnational industries, including the British-owned BAE Systems, an Italian-owned aerospace subsidiary of Finmeccanica; Alenia Aeronautica, and EADS, a European conglomerate of Airbus, Eurocopter, EADS Astrium, and EADS Defence and Security.²² Another European consortium, *EUROJET Turbo GmbH*, is also responsible for the development and production of the Eurofighter's EJ200 engines.²³ From the beginning, the Eurofighter has been a model for collaborative design, and this collaborative effort was also reflected in the production of the aircraft itself.

Production of the Eurofighter is strategically designed to disperse labour equally between each of the four original member states. Indeed, the production of the Eurofighter is truly an international affair, with the front fuselage built by BAE in Britain, the right wing built in Spain by EADS, the left wing in Italy, and the centre section built by EADS Deutschland.²⁴ Ultimately,

however, each partner state is responsible for the final assembly of their own Typhoons, an approach that has secured some 30,000 jobs in Germany, 24,000 in Italy, 22,000 in Spain, and 40,000 in the U.K.²⁵

While production responsibility lays with Eurofighter GmbH, the North Atlantic Treaty Organization (NATO) maintains overall responsibility for acquisition and maintenance of the aircraft on behalf of the member states' Air Forces. The NATO Eurofighter Tornado Management Agency (NETMA), adds a curious layer of strategic transnational governance that merits some discussion around the diverging goals of NATO and the emerging intergovernmental European Security and Defence Policy (ESDP). The expressed goal of the ESDP is to integrate European military decision-making and capacity around a uniquely European policy.²⁶ Within some circles, NATO is seen as the constructed extension of American military power into Western Europe; thus, the continued rationale for NATO's overseeing of both airframe and engine development is confounding.²⁷

The Typhoon's production scheme reaffirms a liberalized, all-European development strategy that focuses on the development of a product fit for export. In fact, in 2007 the Austrian Air Force purchased 15 aircraft and in 2006 Saudi Arabia finalized an order for 72 aircraft.^{28 29} By late 2009, the Eurofighter program had resulted in the production of just under 200 aircraft of a total order of 707.^{30 31}

The F-35

The F-35 Lightning II represents the United States' largest military acquisition in history, and as a 2004 Government Accountability Office (GAO) memo plainly states, "... has the potential to significantly affect the worldwide defense industrial base."³² Arguably, the F-35 program was inspired by the failure of a prohibitively expensive domestic aerospace program and a need

to maximize cost efficiency within the three branches of the U.S. military. Unlike the collaborative, consortium-led approach employed by the Europeans, the outcome of the Joint Strike Fighter program utilized a final competitive bid process between American aerospace giants Boeing and Lockheed Martin, the only independent aerospace firms capable of producing such an aircraft (as discussed earlier). Throughout the process, international partner-states were encouraged to ‘buy-into’ the program through a multi-tiered partnership agreement that allowed limited access to JSF development contracts. Undoubtedly, the U.S. is Lockheed Martin’s largest customer, so it is only natural that a significant proportion of the aircraft’s development remain within the U.S. However, production of the F-35 remains a relatively closed process that is designed to protect U.S. industrial interests in the Aerospace sector.

The ultimate failure of Lockheed Martin’s F-22 Raptor program is a cornerstone in the development of the F-35, and a telling indicator of drastic change in the nature of domestic materiel production. In July 2009, the President of the U.S. and Congressional and Senate Democrats blocked funding for the further procurement of any additional F-22 Raptors, finally signalling the end of a program that had attracted years of criticism for its ballooning costs and unforeseen shortcomings.³³ Initially envisioned at a program cost of \$150 million per unit, the F-22 was estimated at well over \$300 million per unit by 2005, and many attributed these drastic cost increases to an uncompetitive environment wrought by industrial aggregation within the United States.^{34 35} Furthering the controversy over the cost, the U.S. Air Force was predicted to be Lockheed Martin’s only purchasing customer, as the aircraft was the subject of a Congressionally legislated ban on the export of the aircraft. Designed to “...[protect] U.S. intellectual property in F-22 technologies and denying adversaries access to these technologies,”³⁶ the ban reaffirmed the fact that the state was still very much interested in maintaining strict export controls on its military assets, even in the

face of prohibitively escalating costs. Ultimately, the F-22 program was cancelled after the production of only 187 aircraft, and its replacement would be the smaller, cheaper, and, perhaps most importantly, exportable F-35 Lightning II.³⁷

The regional development scheme of the F-35 focuses on domestic production and leverages limited international partnership to help defray costs. The aircraft, which is actually comprised of three unique variants that utilize 80 per cent common parts, will be largely produced in California and Texas, and the final assembly of all components will occur exclusively in Fort Worth, Texas.³⁸ At the time of this writing, nine international partner states have bought into the JSF program, a membership that allows their respective aerospace firms to bid on small or subsidiary development tasks on a predicted production run of over 3000 aircraft.^{39 40} Perhaps the most contentious aspect of the Joint Strike Fighter program is Lockheed Martin's demand that, in order to achieve the lowest possible production cost, partner states forego traditional, protectionist *offset* measures designed to insulate domestic industry from the cost of foreign asset acquisition.⁴¹ Typically, two types of offset measures have been used to protect domestic firms: *traditional direct* offsets, where a foreign prime contractor is obliged to integrate domestic hardware into the foreign contract at hand, and *general direct* offsets, where domestic industry is offered the ability to contribute to the prime contractor's product prior to being sold into the global market.⁴² Put in simpler terms, *offset* measures reassure states purchasing goods from foreign markets that at least some of the money used to purchase those assets will be reinvested into its own domestic economy, theoretically ensuring the vitality of sectors that may have been hurt by the decision to buy from foreign, instead of domestic, firms. In the case of the F-35, neither of these offset options have been made available.⁴³ In lieu of defined offset measures, states who have elected to sign on to the project are offered exclusive access to bid on lucrative sub-system contracts.⁴⁴ Participating states shape their commitments and returns by

entering into the JSF program in one of three industrial tiers: tier one requiring the investment of approximately \$2 billion,^c tier two demanding roughly \$1 billion, and tier three partners investing around \$100 million.⁴⁵ These funds are not paid directly to the JSF's American prime contractors but are instead held as domestic, liquid capital that is to be made available (in loans) to domestic firms interesting in participating in the JSF program. Therefore, the program 'buy-in' process actually resembles that of a strategic stimulus plan, designed to make partner states more competitive within the closed F-35 sub-system contract market. Of course, access to a competitive bid process does not assure returns on investment, as the spoils of the project will only be granted to lowest bidders, a matter that will be explored using Canada as a case study later in this paper.

In a move reflecting the congressional export ban on the F-22, Lockheed Martin and the United States government has reaffirmed that the F-35's integral operating software will not be shared with any partner state.⁴⁶ Eight million lines of software, which manages flight controls, weapons systems, communication, and navigation, must be programmed at a specially designed facility at Eglin Air Force Base in Florida.⁴⁷ Referring to other partner states, JSF program director John Schreiber stated "Nobody's happy with it completely. But everybody's satisfied and understands."⁴⁸ In addition, it appears clear that all international military personnel designated to fly their respective state's F-35's will be trained at a specially designed facility at Eglin Air Force Base, Florida, instead of within their own state's purview and borders.⁴⁹

Finally, one would be remiss in not mentioning what appear to be significant setbacks in the unfolding of the JSF program. In April of 2011, the U.S. Government Accountability Office (GAO)

^c Tier one partners retain full decision-making rights in the program. Great Britain is the only state to be included as a tier one partner.

expressed their concern that the program was underperforming in three broad areas: the increasing need for engineering redesigns late into the pre-production stage, an underestimation of time needed for software development, and marked shortcomings in achieving clearly defined testing, contracting and manufacturing goals.⁵⁰ These setbacks are considerable, especially to the B variant of the aircraft, which, as the program's own director has stated, will be cancelled unless current issues can be resolved.⁵¹ In June 2010, the JSF program officially breached the Nunn-McCurdy threshold, a law enacted in 1983 designed to limit or terminate acquisitions that exceed their projected baseline costs by more than 25 per cent. By 2010, the F-35 program had grown to between 57 and 89 per cent above its 2002 program baseline, a situation which then required the Secretary of Defense to inform Congress of the overruns, to certify that the program is essential to national security, and to provide a corrective course of action.⁵²

Analysis: Understanding Defense-Oriented Regionalism

The aggregation of global aerospace prime contractors in the post-Cold War era presents significant challenges to realist and liberal theories of political economy. Indeed, gaining an insightful perspective on the relevance of these two programs requires the forfeiture of the clearly defined theoretical taxonomy in favour of a blurrier and perhaps more unsatisfying understanding of the origins, necessity, and future of defense-oriented regionalism through the lens of the aerospace sector. Once defence-oriented regionalism has been defined conceptually, we may assess its potential impacts on domestic aerospace industries. Admittedly, the majority of this analysis is committed to understanding the relevance of the F-35 to global and regional economic communities, as the Eurofighter is a mature piece of technology already in production in various European states. With Canada, a current third-tier partner in the JSF program, this analysis will also feature the impacts of the program on domestic military and industrial capacity. However, with the F-35 program still

unfolding, and many Canadians embroiled in debate over the program, it must be stated that this analysis claims no allegiance to establishing one program's superiority over another; instead, the reader is encouraged to draw on any and come to their own conclusions.

Through the lens of near-orthodox liberalism, these international development regimes seem only natural. In a competitive market environment, the creation of competitive, international supply-chains will drastically reduce final product costs while at the same time allowing partner states access into lucrative, pre-production development contracts. Although this paper has only briefly discussed the prevalence of international trade regimes like the WTO and NAFTA, the regional development programs driving these aircraft are in themselves similar to transnational regimes like the EU community, NAFTA, and the WTO in that partner states enter into common understandings about their role in production and development. The European approach to regime building differs greatly from the American approach. The transnational regime governing the production of the Typhoon is one that centers on transparency and reward where member states retain rights to major sub-systems and final assembly within their own borders, thus developing, or at least maintaining, domestic industrial knowhow. As socially-oriented as the program may be, the approach to development cannot be fully explained under the banner of orthodox liberalism. Ultimately, the aircraft is being produced in five locations, with a complex network of just-in-time logistics dictating the rate of production and cost per unit. If planners were truly concerned about achieving the best cost-per-unit, and thus delivering the best value to their taxpaying publics, the production program would be much more centralized within a single location. According to one source, each of the four main Eurofighter production lines represents a 130 million Euro investment in start-up and annual maintenance, representing a considerable duplication of effort.⁵³ However, all is not lost for the liberal school of thought. The

notion of comparative advantage, or states capitalizing on favourable domestic labour environments to produce high-demand exportable products, appears alive and well within the four major Eurofighter states; on average, those working on the production line in Germany may earn up to 65.6k Euro, while the same line worker in the UK earns only 30.4k Euro.⁵⁴ So, while the Eurofighter may represent the benefits of European unionization, citizens are not necessarily benefiting from the program equally. Relative to the Eurofighter, the F-35 has followed a highly centralized development scheme from inception. The F-35's governing regime, the Joint Strike Fighter (JSF) program, has ensured that major production and *all* final assembly remains within the United States' borders and, as explained above, utilizes a tiered, competitive bid process to award sub-contracts to industrial partners within members states. Nevertheless, as long as national security remains a variable in the formula, it is impossible to imagine either of these programs existing within an orthodox liberal architecture. States are obliged to protect themselves, and opening the door to procurement from the lowest international bidder introduces a host of concerns.

An orthodox realist would likely see both of these development schemes as an existential risk to national security, both in the risk of interruption of supply to materiel during crises, and the possible leak of proprietary information into hostile hands. Although there is a place for international trade in the realist's perception, the production of defense material is not traditionally one of them. Of the two programs, the F-35 remains closest to the traditional, realist interpretation of a domestic economy protected from outside influence. But perhaps it is time to reconsider the traditional interpretation. If Machiavelli's treatise on power is still relevant, one acknowledges that the city-state he once wrote of is now a complex federation of provinces and states. The orthodox realist could go one step further, asserting that regimes like the North Atlantic Treaty Organization (NATO), the former Warsaw Pact, and the European Common Security and Defence Policy

(CSDP) are the next evolutionary unitary actors in the realist sense. After all, there is no denying the strategic nature of these partnerships both in the military and economic realms. The U.S. Air Force clearly states that the F-35 will "...maintain the margin of superiority we have come to depend upon, the margin that has granted our forces in the air and on the ground the freedom to maneuver and to attack."⁵⁵ In another public statement, the economic stratagem is equally as clear. The Department of Defense has actively pursued allied participation as a way to defray some of the costs of developing and producing the aircraft and to "prime the pump" for export sales of the aircraft."⁵⁶ Now, considering the re-framing of the unitary actor and the U.S.'s overt military and economic agenda, it becomes much easier to situate the F-35 almost entirely within the realist perspective of defense acquisition. Barring the Eurofighter's decidedly social orientation, its original inception is partially explained by a realist need to safeguard European aerospace industries from extinction in the face of growing American market dominance.

In the most practical sense, neither the liberal nor realist perspective can wholly explain the emergence of complex, defense-oriented regional relationships or clusters. Like generations of American aircraft that have come before it, the F-35 is an opportunistic program designed to satisfy the need to replace a fleet of legacy aircraft, while at the same time ensuring that the product remains marketable to international customers. Arguably, this approach has more to do with the astronomical costs associated with the development and production of modern fighter aircraft than it does the willing extension of national hegemonic power. In fact, according to some estimates, the cost of producing a fighter aircraft, adjusted for inflation, doubles every eighteen years.⁵⁷ ^d This means that strategic regional communities of states

^d The methodology behind this estimate is contentious, as this particular report used weight as a basic unit of comparison. Including certain built-in assumptions on the increase of aircraft size and mass, one kilogram of fighter aircraft in 1950 was compared to one kilogram of fighter aircraft in 1990.

are required to share the risk inherent in high-value defense procurement. The European region and the North American region have followed unique pathways to procurement in the hopes of satisfying ironically common goals. For the most part, the Joint Strike Fighter is being developed under U.S. terms and laws and is designed to spread the financial risk of re-capitalizing large Naval, Marine and Air Force aerial fleets with many international partners. The Eurofighter, which is a much smaller program in comparison (some 700 aircraft versus the F-35's 3000 plus), is illustrative of Europe's tendency towards marginal defense spending, while at the same time attempting to protect domestic industrial capacity against intrusion from American influence. Although the Eurofighter was conceived of and produced earlier than the F-35 program, it can clearly be viewed as an attempt to mitigate the influence of the U.S. aerospace within Europe.

Theoretical examination of these case studies offers an intriguing look at global trends; however, little insight is gained around the actual domestic effects of partnership in defense regions. Canada's proposed F-35A acquisition has stirred considerably debate in Parliament, major media outlets, and even on streets and in classrooms across the country. These discussions reveal two major elements of partnership that are worth exploration. The first element focuses on the economics of acquisition and is largely concerned with illustrating the benefits and drawbacks of participation in such a large project. The second, possibly more contentious, element concerns the effects that JSF participation will have on the sovereignty of decision-making when it comes to Canadian military doctrine.

Canada is a third tier partner in the JSF program and has subsequently invested \$150^e million into the pre-production phase.⁵⁸ This access afforded Canadian industry the ability to bid

^e Of which \$100 million originated from the Department of National Defense, the other \$50 million coming from Industry Canada's Technology Partnership Fund. Williams, *Reinventing Canadian Defense Procurement*, 52.

on 376 sub-contract competitions, of which 90 per cent were actually bid upon.⁵⁹ 65 Canadian firms, universities, and government agencies won just over 40 per cent of these competitions for an estimated predicted value between \$4.8 and \$6.8 billion (USD) over the production lifespan (2002-2023) of the F-35 program.⁶⁰ If the program develops as expected and these figures are realized, there is little doubt that Canada can expect to fully recoup its initial research and development investment of \$150 million. What is less certain is the price Canada will pay for its planned acquisition of 65 F-35A's (conventional take off and landing variant). Fortunately, it is the B variant (vertical take-off and landing or VTOL) and to some extent the C variant (carrier based), that has been experiencing critical design setbacks. Unfortunately, with all three variants so intrinsically linked in component sharing and production, setbacks for one variant will inevitably affect the other programs - if not in the rate-of-production, then certainly in the per-unit cost. Perhaps more than any other issue, Canadians find themselves embroiled in debate over what they believe to be the uncertainty of the cost of these aircraft, an understandable quarrel considering that the price-per-unit ranges from around \$110 million⁶¹ to the Parliamentary Budget Officer's (PBO) estimate of nearly \$168 million per jet. Unfortunately, no two cost analyses have taken into account the same factors and therefore cannot be compared with any accuracy. The lower figure actually represents the cost of the air vehicle without the cost of engines,⁶² which add an anticipated \$15 million on to the unit price of each aircraft.⁶³ In the wake of the PBO's high cost analysis, various reports were issued heavily criticizing the top-down statistical methodology of the PBO (Analysis of Parliamentary Budget Officer Cost Estimates for the Joint Strike Fighter Project).⁶⁴ It is, therefore, dubious to rely on either figure as an accurate analysis of cost; however, it is probably fair to assume the exact figure lays somewhere in the middle of that range, as individual costs are dependent on everything from the state of the production line to the sustained commitment of other international partners. If nothing else, Canadians must expect the

actual price of the aircraft to fluctuate in conjunction with the project demands and setbacks. If production can return to schedule and the number of international partners increase, we can safely assume the price of the aircraft to drop. If the B variant of the aircraft does indeed fail, and international partners withdraw from the program, we may assume the price per-unit to climb. This simple take on an incredibly complex production plan should illustrate the most basic economic consequences of domestic participation in a regional defense scheme. Flexibility of price is key, and Canadians should be prepared to see the price debate continue in coming years, or at least as long as Canada remains a partner in the JSF program.

It should be clear by now that large-scale defense acquisitions like the Eurofighter and F-35 create intertwined economies of scale, but what is considerably less clear is the effect they have on domestic military doctrines. For instance, does a low-level state partner in the F-35 project forfeit some measure of military sovereignty of action in favour of allied preferences within that region? Perhaps it is here that this paper must come face-to-face with its own technical determinism in placing fighter aircraft at the focal point of regional defence communities. All too often, pundits, historians, and politicians cite the decisive merits of various weapons systems in the execution of foreign policies, or the decisive role technology plays during times of conflict. In reality, weapons systems are sub-systems within a greater military system that is guided by firm doctrine and led by rational, humane leadership. When it becomes necessary to acquire higher-value military hardware, this leadership is responsible for formally framing its requirements, and civilian public servants are responsible for tendering out the contract. Procurement follows military doctrine, not the other way around. Interestingly, one may look to the Eurofighter's recent role in Libya for proof of this, as Great Britain was the only state to deploy these aircraft to the region. However, just like industry in the economic realm, programs like the JSF expose state military institutions to varying

levels of risk, especially in states that are looking to quickly replace increasingly unserviceable aircraft. If existing aircraft are retired before they are effectively replaced, air forces are left with a gap in their capacity to perform various mission types. Australia, an F-35 partner, is just such an example. Due to earlier than expected rust-out of its fighters, the Royal Australian Air Force was forced to retire its F-111's early and purchase 24 F/A-18F aircraft from Boeing (Lockheed's main continental competitor) in order to temporarily fill their capacity gap.⁶⁵ Canada expects delivery of its first F-35A's in early 2016, at which time it will likely begin phasing out the CF-188 before it reaches the end of its serviceable lifespan in 2020.⁶⁶ If F-35 deliveries do slip, and aircraft are delivered years after their expected dates, Canada may face a situation similar to that of Australia.⁶⁷ Finally, and perhaps most contentiously, Canada is already a member of NATO and North American Air Defense (NORAD). The decision to purchase the F-35A alongside side its allies does not create new defense alliances, but strengthens existing ones. In a speech before the Standing Committee on National Defense, Canada's Chief of the Air Staff, Lt. General André Deschamps illustrates these alliances clearly:

We need a capability that helps us carry out our core missions of defending the sovereignty of Canadian and North American airspace through NORAD, providing Canada with an effective and modern capability for international operations, and effectively conducting joint operations with our Allies through NATO or a coalition.⁶⁸

If the U.S. retains its exclusive aircraft maintenance and pilot training schemes (as mentioned above), Canada may face considerable, but surmountable sovereignty issues regarding its asset management. However, Canadians should not be concerned that JSF partnership brings additional military responsibilities, at least no more than NATO and NORAD already demand.

Conclusion

High-value aerospace production offers a tantalizing look at current state of international military procurement practices. Ironically, the F-35 and Eurofighter Typhoon are a dying breed, as most states have announced their intention to end production of manned fighter aircraft.⁶⁹ In their place, cheap, unmanned, remotely controlled vehicles will take to the skies to fulfill a variety purposes. Besides being deeply saddening to the author of this paper, this shift in production focus, coinciding with drastic drops in per-unit prices, will undoubtedly deflate the economic and doctrinal influence of regional aerospace production schemes. Until then, the F-35 and Eurofighter stand as unique products of defense regions that, in both cases, are focused on sustaining domestic industrial capacity into the future. Unlike smaller defense acquisitions, fighter aircraft have the ability to shape both international markets and domestic economic policies of partner states. However, as these two aircraft have proven, their development schemes defy traditional political taxonomy by applying liberal, market-driven cost control measures while at the same time operating within greater, protectionist schemes that greatly benefit the U.S. in the case of the F-35, and Germany, Italy, Great Britain, and Spain in the case of the Eurofighter.

Notes

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